No. 77-29

In the Supreme Court of the United States

OCTOBER TERM, 1977

ALAN NEMSER AND SELMA W. NEMSER, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

WADE H. MCCREE, JR.,
Solicitor General,
Department of Justice,
Washington, D.C. 20530.

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The question presented in this federal income tax case is whether petitioners were correctly denied a deduction under Section 642(h)(2) of the Internal Revenue Code of 1954 (26 U.S.C.), which provides that, upon the termination of an estate or trust which has deductions in excess of its gross income for its last taxable year, such excess deductions shall be allowed to "the beneficiaries succeeding to the property of the estate or trust."

Petitioner[1] purchased a fractional part of a remainder interest in a testamentary trust. Upon termination of the trust in 1968, certain securities were distributed to him as his

[1]"Petitioner" refers to Alan Nemser. Selma W. Nemser is a party solely because she filed a joint return with her husband for the year at issue.

share of the trust's assets (Pet. App. 3a, 11a, 13a). For 1968, the trust's deductible expenses exceeded its income, and petitioner reported a deduction of $14,394.12 under Section 642(h)(2), equal to his claimed share of the excess deductions of the trust (Pet. App. 3a-4a, 13a). The Tax Court upheld the Commissioner's determination that petitioner was not entitled to a deduction under Section 642(h) because, as a purchaser of his interest in the trust, he was not a "beneficiary succeeding to the property of the trust" within the meaning of Section 642(h)(2) (Pet. App. 1a-7a). The court of appeals affirmed (Pet. App. 8a-9a).

The courts below correctly held that petitioner was not entitled to a deduction under Section 642(h) for the excess deductions of the trust in which he purchased an interest. In the only other reported decision under Section 642(h), the Tax Court likewise held that a lawyer to whom estate property had been assigned as compensation for legal services did not qualify as a "beneficiary succeeding to the property of the estate" for purposes of qualifying for the excess deduction pass-through provided by Section 642(h)(2). *Sletteland* v. *Commissioner*, 43 T.C. 602. There, the Tax Court ruled that Section 642(h) was inapplicable to persons who, like petitioner, acquire an interest in an estate or trust for a valuable consideration, and not as a beneficiary of the decedent or settlor.

As the Tax Court stated in this case (Pet. App. 5a), Section 642(h) was added to the 1954 Code to permit beneficiaries succeeding to the property of an estate or trust to deduct incurred excess losses upon termination of the estate or trust. See H.R. Rep. No. 1337, 83d Cong., 2d Sess. 62 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 83, 343 (1954). The use of the phrase "beneficiaries succeeding to the property" in Section 642(h)(2) indicates that the provision encompasses only recipients of property

by bequest or gift. As the court explained in *Renton Inv. Co.* v. *Commissioner*, 131 F. 2d 330, 335 (C.A. 9), "[A beneficiary is] one who receives anything as a gift; one who receives a benefit or advantage; the recipient of another's bounty * * *."

Here, however, petitioner is not a "beneficiary succeeding to the property" within the meaning of the statute. To the contrary, he was a purchaser for value. Petitioner's basis in the property purchased would therefore be determined under Section 1012 by reference to the cost of the property, and not under the special provisions applicable when property is acquired from a decedent (Sections 1014 and 1023), or is acquired by a gift or transfer in trust (Section 1015). Excluding the purchaser of an interest in a trust from the benefits of Section 642(h) is entirely consistent with the different tax treatment accorded purchasers of trust interests and those who receive such interests by gift or devise.

Contrary to petitioner's argument, the decision below does not conflict with *Blair* v. *Commissioner*, 300 U.S. 5. In *Blair*, the issue was whether the donor of certain income interests in a trust was liable for income tax on the income distributions, despite the assignments of those income interests to his children. In holding the donor was not liable, this Court applied the general principles relating to assignment of income, noting that under the revenue acts "tax liability attaches to ownership" (*id.* at 12).

Here, unlike *Blair*, there is no question concerning the proper taxpayer for purposes of trust income distributions. The dispositive point here is that a purchaser of a trust interest is not taxed as a beneficiary, but, instead, is taxed as an investor on any gain realized from the transaction. Accordingly, the Court's statement in *Blair* that the assignee of the beneficial interest "becomes the beneficiary"

(*ibid.*) cannot be read to address the wholly different question here involving the scope of Section 642(h), which was enacted long after the decision in that case.

It is respectfully submitted that the petition for a writ of certiorari should be denied.

WADE H. MCCREE, JR.,
Solicitor General.

AUGUST 1977.